

Michigan Supreme Court Ruling in Ally Financial Provides Insight for Refund Claims

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On Friday, July 20, 2018, the Michigan Supreme Court filed its opinion in [*Ally Financial Inc. v. State Treasurer*](#), Michigan Supreme Court Docket No. 154668, which was consolidated with [*Santander Consumer USA Inc. v. State Treasurer*](#), Michigan Supreme Court Docket Nos. 154669 and 154670 (collectively, Ally Financial and Santander are referred to as "Ally" for purposes of this summary).

The business of Ally included purchasing installment sales contracts between automobile dealerships and dealership customers. Ally paid the dealership for the vehicle purchased, including sales tax, and the dealership assigned the customer's installment payments to Ally. If a customer defaulted, it was Ally's responsibility to pursue collection action, including repossession of the vehicle. In some cases, Ally could only repossess a vehicle, resell it for less than the amount due on the installment contract, and write off the remaining debt. As provided under MCL 205.54i, Ally sought a Michigan sales tax refund on the amounts that were written off as bad debts for federal tax purposes. The Michigan Department of Treasury ("the Department") rejected the refund claims on the following bases:

1. The definition of "bad debt" at MCL 205.54i specifically excludes "repossessed property."
2. Ally did not provide validated RD-108 forms from the Michigan Secretary of State proving the fact and amount of sales tax paid.
3. Ally did not provide a valid election demonstrating its entitlement to claim the sales tax refund.

Amounts Written Off Are Bad Debts

As to the Department's first basis, the court found in favor of Ally. Reviewing the statutory context and case law interpreting similar statutes in other states, the court held that the exclusion of "repossessed property" from the definition of "bad debt" was meant to refer only the value of the repossessed property, not the entire debt to which the repossessed property related. Thus, the amount of "bad debt" eligible for a sales tax refund excludes the amount received when a repossessed vehicle is sold, but it includes any uncollected amount remaining on the account.

Form RD-108 Could Be Required

Regarding the Department's request for validated RD-108 forms, the court determined that this substantiation requirement was a proper exercise of the Department's discretion under MCL 205.54i. According to the language of the statute, a claim for a bad debt deduction should be "supported by that evidence required by the department." The court held that there was a "rational basis" for the Department's insistence on validated RD-108 forms. This "rational basis" apparently existed because (1) those forms evidence both the fact and amount of the sales tax payment, (2) the RD-108 forms were available to the taxpayer from the Secretary of State for a "reasonable cost," and (3) the Department provided specific guidance regarding the fact that the RD-108 forms were required to obtain a refund. The taxpayer's spreadsheets, offered in place of the forms, did not provide this same evidence.

Ally's Elections Were Valid

Finally, the court held that the election allowing Ally to claim the sales tax refund was effective. The statute requires that the taxpayer who reported the tax (the automobile dealerships in this case) and the lender holding the receivable "maintain a written election" regarding which party may claim the tax deduction or refund related to bad debts. The Department pointed to language within the parties' election documents that permitted Ally to claim potential sales tax refunds or deductions related to bad debts on "any and all Accounts currently existing or created in the future." Since the elections were executed between 2012 and 2014, the Department argued that they did not apply to accounts written off prior to those dates because such accounts were not "currently existing." The court, however, found that a write-off is simply an "internal recognition by a lender that an account is worthless," not an elimination of the debt. Thus, the accounts written off prior to 2012 were "currently existing" at the time the elections were executed and the elections were valid.

Although this decision interprets a very specific portion of Michigan's sales tax statute, it provides important general guidance to taxpayers seeking tax refunds. When the Department has statutory authority to exercise discretion in granting refunds, the requirements imposed by the Department will be respected by the courts if they have a rational basis. In this case, the Court was reluctant to find no rational basis for the RD-108 form requirement, particularly when the forms were available and the taxpayer chose not to produce them. It is also worth noting that Revenue Administrative Bulletin 2015-27, *Sales and Use Tax Bad Debt Deduction*, approved December 2, 2015, specifically requires a taxpayer requesting a sales tax refund based on a bad debt deduction to provide RD-108 forms for each vehicle for which the deduction is claimed. When the Department provides guidance to a taxpayer regarding the substantiation required for a refund claim and such substantiation is available at a reasonable cost, a taxpayer's attempt to substitute its own "equivalent" documentation is likely to be met with resistance by the Court. However, the corollary of this rule arguably provides greater certainty for taxpayers: if the Department exercises its discretionary authority and advises a refund claimant regarding what documentation is required, once a taxpayer provides such documentation, the refund should be approved as the Department's advice should be respected by both the Department and the Courts in evaluating the refund claim.

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